OBJECTIVE III. Determine whether the separate affiliate required under section 272 of the Act has officers, directors, and employees that are separate from those of the Bell operating company.

STANDARDS

The FCC in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, interprets the above requirement further by stating the following:

- Separate officers, directors, and employees simply dictates that the same person may not simultaneously serve as an officer, director, or employee of both a BOC and its section 272 affiliate. (See First Report and Order, para. 178.)

PROCEDURES

1. Inquire, document and disclose in the report whether each section 272 affiliate and each Verizon BOC/ILEC maintain separate boards of directors, separate officers, and separate employees. For each Verizon BOC/ILEC and section 272 affiliate, obtain a list and written confirmation from the Corporate Secretary's Office of the names of directors and officers of the Verizon BOC/ILEC and section 272 affiliate, including the dates of service for each Board member and officer for the engagement period. Compare the list of names of directors and officers of each Verizon BOC/ILEC with the list of names of directors and officers of each section 272 affiliate. For those names appearing on both lists, obtain explanations from management and request social security numbers and addresses to ensure that they are not the same individuals. Disclose in the report the number of directors and officers (who have the same social security number and address) who served simultaneously as a director and/or officer of any Verizon BOC/ILEC and any section 272 affiliate.

2. Obtain a list of names and social security numbers of all employees of each section 272 affiliate and each Verizon BOC/ILEC for the engagement period. Compare all names and social security numbers of employees and document in the work papers the names appearing on both lists, respectively. For any employee appearing on both lists simultaneously, inquire and document why in the report. For privacy reasons, do not include the names or SSNs of any Verizon employees in the report.

<u>OBJECTIVE IV</u>. Determine that the separate affiliate required under section 272 of the Act has not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company.

<u>STANDARDS</u>

The FCC in 47 C.F.R. 53.203(d) indicates that a section 272 affiliate shall not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the BOC of which it is an affiliate.

The FCC also expands on this premise in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended. In this docket the Commission states that,

- A BOC cannot co-sign a contract or any other instrument with a section 272 affiliate that would allow each section 272 affiliate to obtain credit granting recourse to the BOC's assets. (See First Report and Order, para. 189)

- The BOC parent, or any other non-section 272 affiliate, cannot sign or co-sign a contract or any arrangement with a section 272 affiliate that would allow the creditor to have recourse to the BOC assets. (See First Report and Order, para. 189)

- A section 272 affiliate cannot enter any arrangement with any party that would permit the lender to have recourse to the BOC in the event of a default. (See First Report and Order, para. 189)

<u>PROCEDURES</u>

1. Document in the workpapers each section 272 affiliate's debt agreements/instruments and credit arrangements with lenders and major suppliers of goods and services. Look for guarantees of recourse to the Verizon BOC/ILECs' assets, either directly or indirectly through another affiliate, and document those instances and disclose in the report. Major suppliers are those having $500,000 or more in annual sales to the section 272 affiliate as stated in the agreement.

2. Using the lease agreements that were entered into or modified during the Test Period obtained in Objective II, Procedure 3, document any instances in which each section 272 affiliate's lease agreements (where the annual obligation is $500,000 or more as stated in the agreement) have recourse to the assets of any Verizon BOC/ILEC, either directly or indirectly through another affiliate, and disclose in the report.

3. For all debt instruments, leases, and credit arrangements that were entered into or modified during the Test Period that are maintained by each section 272 affiliate in excess of $500,000 of annual obligations and for a sample of 10 debt instruments, leases and credit arrangements that are less than $500,000 in annual obligations (judgmental sample), obtain positive confirmations from loan institutions, major suppliers, and lessors to attest to the lack of recourse to any Verizon BOC/ILEC's assets. Disclose in the report any recourse noted.

OBJECTIVE V. Determine whether the separate affiliate required under section 272 of the Act has conducted all transactions with the Bell operating company on an arm's length basis with the transactions reduced to writing and available for public inspection.

OBJECTIVE VI. Determine whether or not the Bell operating company has accounted for all transactions with the separate affiliate in accordance with the accounting principles and rules approved by the Commission.

STANDARDS

The FCC in CC Docket No. 96-150, In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, noted that the separate affiliates required under section 272(a) were required to meet the requirements of section 272(b) governing maintenance of books, records, and accounts, and, pursuant to section 272(c)(2), BOCs were required to account for all transactions with such affiliates "in accordance with accounting principles designated or approved by the Commission." (See para. 110)

The FCC in CC Docket No. 96-149, In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, interprets the above requirements further by stating:

> A section 272 affiliate shall conduct all transactions with the BOC of which it is an affiliate on an arm's length basis, pursuant to the accounting rules described in 47 C.F.R. 32.27, Transactions with Affiliates, of the FCC Rules and Regulations, with any such transactions reduced to writing and available for public inspection. (See Appendix B, Final Rules, 47 C.F.R. 53.203(e))

Section 32.27 of the Commission's rules requires the following:

> **For transactions involving the sale or transfer of assets between the carrier and affiliates:**
>
> a. assets sold or transferred between a carrier and its affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariff rate;
>
> b. nontariffed assets sold or transferred between a carrier and its affiliate that

qualify for prevailing price valuation shall be recorded at prevailing price. In order to qualify for prevailing price valuation, sales of a particular asset to third parties must encompass greater than 25% of the total quantity of such product sold by an entity. Carriers shall apply this 25% threshold on an asset-by-asset basis rather than on a product line basis. See "Exceptions" below;

c. all other assets sold by or transferred from a carrier to its affiliate shall be recorded at no less than the higher of fair market value or net book cost. See "Exceptions" below.

d. all other assets sold by or transferred to a carrier from its affiliate shall be recorded at no more than the lower of fair market value or net book cost. See "Exceptions" below.

Exceptions:
Floor. When assets are sold by or transferred from a carrier to an affiliate, the higher of fair market value and net book cost establishes a floor, below which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or greater than the floor, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive.

Ceiling. When assets are purchased from or transferred from an affiliate to a carrier, the lower of fair market value and net book cost establishes a ceiling, above which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or less than the ceiling, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive.

Threshold. Carriers are required to make a good faith determination of fair market value for an asset when the total aggregate annual value of the asset(s) reaches or exceeds $500,000, per affiliate. When a carrier reaches or exceeds the $500,000 threshold for a particular asset for the first time, the carrier must perform the market valuation and value the transaction on a going-forward basis in accordance with the affiliate transactions rules. When the total aggregate annual value of the asset(s) does not reach or exceeds $500,000, the asset(s) shall be recorded at net book cost.

For transactions involving the provision of services between the carrier and affiliates:

a. services provided between a carrier and its affiliate pursuant to a tariff, *including a tariff filed with a state commission*, shall be recorded in the appropriate revenue accounts at the tariffed rate;

b. nontariffed services provided between a carrier and its affiliate pursuant to publicly filed agreements submitted to a state commission pursuant to section 252(e) of the Communications Act of 1934 or statements of generally available terms pursuant to section 252(f) shall be recorded using the charges appearing in such publicly-filed agreements or statements;

c. nontariffed services provided between a carrier and its affiliate that qualify for prevailing price valuation shall be recorded at the prevailing price. In order to qualify for prevailing price valuation, sales of a particular service to third parties must encompass greater than 25% of the total quantity of such service sold by an entity. Carriers shall apply this 25% threshold on a service-by-service basis rather than on a service line basis. See "Exceptions" below;

d. all other services sold by or transferred to a carrier from its affiliate, shall be recorded at no more than the lower of fair market value and fully distributed cost. See "Exceptions" below;

e. all other services sold by or transferred from a carrier to its affiliate shall be recorded at no less than the higher of fair market value and fully distributed cost. See "Exceptions" below.

Exceptions:
Floor. When services are sold by or transferred from a carrier to an affiliate, the higher of fair market value and fully distributed cost establishes a floor, below which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or greater than the floor, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive.

Ceiling. When services are purchased from or transferred from an affiliate to a carrier, the lower of fair market value and fully distributed cost establishes a ceiling, above which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or less than the ceiling, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive.

Threshold. Carriers are required to make a good faith determination of fair market value for a service when the total aggregate annual value of that service reaches or exceeds $500,000, per affiliate. When a carrier reaches or exceeds the

$500,000 threshold for a particular service for the first time, the carrier must perform the market valuation and value the transaction on a going-forward basis in accordance with the affiliate transactions rules. When the total aggregate annual value of the service does not reach or exceeds $500,000, the service shall be recorded at fully distributed cost.

Fully distributed cost is determined by following the standards contained in 47 C.F.R. 64.901, Allocation of Costs, of the FCC Rules and Regulations. These rules emphasize direct assignment and cost causation. First, costs are to be directly assigned either to regulated or nonregulated activities to the maximum extent possible. Then, costs which cannot be directly assigned are to be grouped into homogeneous cost pools and allocated in accordance with direct or indirect measures of cost causation. Residual costs which cannot be apportioned on any cost-causative basis will be apportioned using the general allocator. The general allocator is the ratio of all expenses directly assigned or attributed to nonregulated activities, to the total of all (regulated and nonregulated) directly assigned or attributed expenses.

A BOC and a section 272 affiliate may provide in-house services to one another. These in-house services, however, must be provided on an arm's length basis, and must be in writing. (See CC Docket No. 96-149, First Report and Order, para 180; see also WC Docket No. 03-228, Report and Order, para. 8, 12, 16, 24, 31)

Provision of exchange and exchange access services and unbundled network elements constitute transactions requiring disclosure (See CC Docket No. 96-150, Report and Order, para. 124). These transactions include the provision of transmission and switching facilities by the BOC and its affiliate to one another. (See CC Docket No. 96-149, First Report and Order, para. 193)

The separate affiliate must provide a detailed written description of the asset or service transferred and the terms and conditions of the transaction on the internet within ten days of the transaction through the company's home page. (Note: a transaction is deemed to have occurred once the BOC and its affiliate have agreed-upon the terms and conditions of the transaction, not when the service is actually performed or the asset actually sold (See CC Docket No. 96-150, Report and Order, para. 124).) The description of the asset or service and the terms and conditions of the transaction should be sufficiently detailed to allow evaluation of compliance with accounting rules. This information must also be made available for public inspection at the principal place of business of the BOC. The information made available at the principal place of business of the BOC must include a certification statement identical to the certification statement currently required to be included with all Automated Reporting and Management Information System ("ARMIS") reports. Such certification statement declares that an officer of the BOC has examined the submission and that to the best of the officer's knowledge all statements of fact contained in the submission are true and the submission is an accurate statement of the affairs of the BOC for the relevant period. (See CC Docket No. 96-150, Report and Order, para. 122)

Section 272(b)(3) does not preclude an affiliate of the BOC, such as a service affiliate, or the parent company of both the BOC and its section 272 affiliate from performing functions for both the BOC and its section 272 affiliate. The affiliate transaction rules apply to transactions between the BOC and a nonregulated affiliate of the BOC, such as a service affiliate, and to transactions between the BOC and its parent company. Under the principle of "chain transactions," the affiliate transactions rules also apply to any transactions between the section 272 affiliate and a nonregulated affiliate of the BOC, such as a service affiliate, that ultimately result in an asset or service being provided to the BOC. (See CC Docket No. 96-150, Report and Order, para. 183)

In the case of transactions for assets and services subject to section 272, a BOC may record such transactions at prevailing price regardless of whether the 25% threshold has been satisfied. (See CC Docket No. 96-150, Report and Order, para. 137; CC Docket No. 00-199, Report and Order, Appendix F, Section 32.27)

Nondiscrimination requirements extend to any good, service, facility, or information that a BOC provides to its section 272 affiliate(s) with the exception of joint marketing, which is covered in section 272(g) of the Act. Unaffiliated entities must have equal opportunity to acquire any such good, service, facility, or information. In particular, if a BOC were to decide to transfer ownership of a unique facility, such as its Official Services network, to a section 272 affiliate, it must ensure that the section 272 affiliate and unaffiliated entities have an equal opportunity to obtain ownership of this facility. (See CC Docket No 96-149, First Report and Order, para. 218)

Interstate rate base, revenue requirements, and price cap indices of the BOC must be reduced by the costs related to any regulated facilities transferred to each section 272 affiliate. (See CC Docket No. 96-150, Report and Order, para. 265; see also C.F.R. 61.45(d)(1)(v))

PROCEDURES

1. Document in the working papers the procedures used by the Verizon BOCs & ILECs to identify, track, respond, and take corrective action to competitors' complaints with respect to alleged violations of the section 272 requirements. Obtain from the Verizon BOC/ILECs a list of all FCC formal complaints, as defined in 47 CFR 1.720; FCC informal complaints, as defined in 47 CFR 1.716 and any written complaints made to a state regulatory commission from competitors involving alleged noncompliance with section 272 for the provision or procurement of goods, services, facilities, and information, or in the establishment of standards which were filed during the engagement period. This list should also include outstanding complaints from the prior engagement period, which had not been resolved during that period. The list should group the complaints in the following categories:

    - allegations of cross-subsidies (for Objectives V and VI);

- allegations of discriminatory provision or procurement of *goods, services, facilities*, customer network services information (excludes customer proprietary network information (CPNI)), or the establishment of standards (for Objective VII);

- allegations of discriminatory processing of orders for, and provisioning of, exchange access and exchange services and unbundled network elements, and discriminatory resolution of network problems (for Objective VIII);

- allegations of discriminatory availability of exchange access facilities (for Objective IX);

- allegations of discriminatory availability of interLATA facilities or services not at the same rates and not on the same terms and conditions as the interLATA affiliate (for Objective XI).

For each group of complaints, determine by inquiry and documentation how many of these complaints were under investigation, how many complaints had been resolved and in what time frame they had been resolved, if feasible, and disclose in the report. For those complaints that had been resolved, obtain from management, document and disclose in the report how those allegations were concluded and, if the complaint was upheld, inquire, obtain from management, and document and disclose in the report what steps the company has taken to prevent those practices from recurring. For all complaints that were filed in the previous engagement period, but were still open as of January 3, 2005, determine by inquiry and inspection of documentation how many of these complaints were under investigation as of the end of the current engagement period, how many complaints have been resolved as of the end of the current engagement period (and in what time frame they had been resolved), and disclose results in the audit report. For those complaints that have been resolved, document and disclose in the report how those allegations were concluded, and if the complaint was upheld inquire, obtain from management, and document and disclose in the report what steps the company has taken to prevent those practices from recurring.

Note: Although applicable to complaints pertaining to Objective V/VI, VII, VIII, IX and XI, this procedure appears only once and will be performed only once for Objectives V/VI, VII, VIII, IX and XI. Reporting of the results of this procedure in the final report should be found here under Objective V/VI, Procedure 1, and should include the results for each respective objective.

2. Obtain, from each Verizon BOC/ILEC and each section 272 affiliate, written procedures for transactions with affiliates as of the end of the engagement period. Compare these procedures with the FCC rules and regulations indicated as "standards" above. Note and

describe any differences and disclose in the report.

3. Inquire and describe how each Verizon BOC/ILEC and each section 272 affiliate disseminate the FCC rules and regulations and raise awareness among employees for compliance with the affiliate transactions rules. For this purpose, describe in the report the type and frequency of training, if any, literature distributed, and company's policy, and document the nature of the supervision received by employees responsible for affiliate transactions. Interview employees responsible for the development and recording of affiliate transactions costs in the books of record of the carrier to determine awareness of these rules. Disclose in the report whether these employees demonstrated knowledge of these rules.

4. a. Obtain a listing of all written agreements for services and for interLATA and exchange access facilities between each Verizon BOC/ILEC and each section 272 affiliate which were in effect during the Test Period. Note which agreements are still in effect. For those agreements no longer in effect, indicate the termination date; identify agreements terminated prematurely (prior to the contracted termination date) and document why and disclose in the report. Inquire and document and disclose in the report the provisioning of any service without a written agreement during the engagement period.

   b. Obtain a listing of all written agreements, amendments, and addenda that became effective and were executed during the Test Period. For a statistically valid sample of such agreements, amendments, and addenda, obtain (include in the practitioner work papers) copies of written agreements, amendments, and addenda.

5. Using the sample of the agreements, amendments, and addenda obtained in Procedure 4b, view each company's web site on the internet and compare the prices and terms and conditions of services and assets shown on this site to the agreements provided in Procedure 4b above.
   a) Disclose in the report any instance where an agreement contains an item(s) that does not agree with the corresponding item on the internet, as determined in Attachment 1. Taking those instance(s) where an agreement contains an item(s) that does not agree with the corresponding item on the internet, develop and disclose in the report the error rate as a percentage. This error rate will be developed utilizing Attachment 1 (Columns D and E) and summarized using Attachment 2 (Columns B and C) as provided in this agreed-upon procedures engagement.
   b) The information provided on the internet should be in sufficient detail to allow evaluation for compliance with accounting rules (see Docket No. 96-150, Report and Order, para. 122). Such disclosures should include a description of the rates, terms, and conditions of all transactions, as well as the frequency of recurring transactions and the approximate date of completed transactions. For asset transfers, the

disclosure should include the appropriate quantity and, if relevant, the quality of the transferred assets. For affiliate transactions involving services priced at fully distributed costs or estimated fair market value, the disclosure should include the number and type of personnel assigned to the project and the level of expertise of such personnel (including the associated rate per service unit (e.g. contacts, hours, days, etc)). Service transactions should also disclose any special equipment used to provide the service, and the length of time required to complete the transaction. Additionally, the disclosure should state whether the hourly rate is a fully-loaded rate, and whether or not that rate includes the cost of materials and all direct and indirect miscellaneous and overhead costs, for goods and services provided at FDC. If the information disclosed on the internet is not sufficiently detailed as described in Attachment 1 (Columns G and H), disclose in the report those particular item(s). Taking those instances where the internet did not contain sufficient details, develop and disclose in the report the error rate as a percentage. This error rate will be developed utilizing Attachment 1 (Columns G and H) and summarized in Attachment 2 (Columns D and E) as provided in this agreed-upon procedures engagement. (See CC Docket No. 98-121, In the Matter of Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana; *Memorandum Opinion and Order*; Released October 13, 1998, para. 337.) Obtain copies of these public postings and include in the working papers.

c) Using the same sample as above, obtain a list of the principal places of business (BOC headquarters) where these agreements are made available for public inspection. Using a judgmental sample of locations agreed to by the Joint Oversight Team, by physical inspection, determine whether the same information is made available for public inspection at the principal place of business (BOC headquarters) of the Verizon BOC/ILEC. Where such information is made available electronically at any public inspection site, physically access such information at one location; for the remaining locations confirm that the Company's electronic access is operational and available to interested parties, and the certification statements are available for public inspection. Disclose in the report which database/website is used for the purpose of making agreements available at the principal places of business. Disclose in the report the total number of sampled agreements where an item in the sampled agreement (from step (a) above) does not agree with the corresponding item in the agreement at the public inspection site. Describe any differences and inquire why such differences exist and disclose in the report. If the company makes any claim of confidentiality for nondisclosure, obtain details.

d) Using the same sample as above, document in the working papers the dates when the sample agreements were signed and/or the services were first rendered (whichever took place first) and the dates of posting on the internet. It should be noted that these transactions should be posted for public inspection within ten days of their occurrence. Inquire and note in the report late postings and reasons when posting took place after ten days of signing of agreement or provision of service (whichever took place first). *Document in the working papers the procedures the company has in* place for posting these transactions on a timely basis.

6. Obtain a listing of all nontariffed services rendered by the Verizon BOC/ILECs to each section 272 affiliate during the Test Period. Determine which of these services are made available to both the section 272 affiliates and to third parties.

a. From the services not made available to third parties:

(1). Determine the 9 services/bill detail lines with the highest billing volume in dollars over the Test Period (total Verizon including all BOC/ILECs and all states) that were billed to the section 272 affiliates (total Verizon including all section 272 affiliates). In addition, randomly select one service from among the remaining services for a total of 10 services to be tested. Randomly select three individual non-consecutive months during the Test Period. For each month selected, obtain the section 272 affiliate billing records for all states, all BOC/ILECs, for the 10 "services to be tested" previously identified. Billing records should reflect the billing to all section 272 affiliates. For each of the 10 services to be tested, randomly select 10 billing transactions from the three months of billing records for a total of 100 billing transactions to be tested. (If there are fewer than 10 services not made available by BOC/ILECs to third parties, continue selecting billing transactions until 100 billing transactions are selected from the billing records).

(2). For the sample of billing transactions selected in step 1 above, determine compliance with section 32.27 of the Commission's Rules by comparing unit charges to Fully Distributed Cost (FDC) or Fair Market Value (FMV) to determine if unit charges were priced at the higher of either FDC or FMV. When differences exist between the amount recorded by the BOC/ILEC, the amount billed by the BOC/ILEC, and the amount to be charged in accordance with the affiliate transaction rules, note in the report the number of instances and related amounts, and, inquire, obtain from management, and document in the report the reasons for these occurrences.

(3). For the sample of billing transactions selected in step 1, test each transaction for the proper application of billing rates, including all applicable discounts, surcharges, late fees, etc. Also test that the billed amount was paid by the section 272 affiliate. This can be accomplished, for example, by inspecting the Accounts Receivable record (may be a computer screen) that identifies the method of payment such as check number(s), wire transfer(s), or any inter-company automatic settlement payment and/or treasury payment process, and, if needed, summaries of invoiced amounts corresponding to the amount paid. Obtain copies of relevant documents and records, e.g., screens, summaries, etc., for the work papers. When any differences exist, note in the report the number of instances and the amount by which each item is different than the amount required by the rules and inquire, obtain from management, and document in the report the reasons for these occurrences.

(4). For the sample of billing transactions selected in step 1, test that the transaction was recorded on the section 272 affiliate's books and that the same amount was paid by the section 272 affiliate. Document in the report each instance where the payment by the section 272 affiliate was not properly recorded, and where any differences were found in the recorded versus paid amounts.

b. From the services made available to both the section 272 affiliates and to third parties:

(1). Determine the 9 services/bill detail lines with the highest billing volume in dollars over the Test Period (total Verizon including all BOC/ILECs and all states) that were billed to the section 272 affiliates (total Verizon including all section 272 affiliates). In addition, randomly select one service from among the remaining services for a total of 10 services to be tested. Randomly select three individual non-consecutive months during the Test Period. For each month selected, obtain the section 272 affiliate billing records for all BOC/ILECs for the 10 "services to be tested". For each service to be tested, randomly select 10 billing transactions from the three months of billing records for a total of 100 billing transactions to be tested. (If there are fewer than 10 services made available by BOC/ILECs to both section 272 affiliates and to third parties, continue selecting billing transactions until 100 billing transactions are selected from the billing records).

(2). For the sample of billing transactions selected in step 1 above, determine if the transaction billed to the section 272 affiliate complies with section 32.27 of the Commission's Rules. When differences exist, note in the report the number of instances and the amount by which each item is different than the amount required by the rules, and inquire, obtain from management, and document in the report the reasons for these occurrences.

(3). For the sample of billing transactions selected in step 1 above, test that the transaction was properly recorded in the financial records by the BOC/ILEC and that the payment by the section 272 affiliate was recorded by the BOC/ILEC. For each billing transaction selected, test each transaction for the proper application of billing rates, including all applicable discounts, surcharges, late fees, etc. Also test that the transaction, including the subsequent receipt of payment or the equivalent, was properly recorded by the BOC/ILEC in accordance with the affiliate transactions rules and that the billed amount was paid by the section 272 affiliate. This can be accomplished, for example, by inspecting the Accounts Receivable record of the BOC/ILEC (may be a computer screen) that identifies the method of payment such as check number(s), wire transfer(s), or any intercompany automatic settlement payment and/or treasury payment process, and, if needed, summaries of invoiced amounts corresponding to the amount paid. Obtain copies of relevant documents and records, e.g., screens, summaries, etc., for the work papers.

(4). For the sample of billing transactions selected in step 1 above, test that the transaction was recorded on the section 272 affiliate's books and that the same amount was paid by the section 272 affiliate. Document in the report each instance where the payment of the bill by the section 272 affiliate was not properly recorded, and where any differences were found in the recorded versus paid amounts.

7. Obtain a listing of all services rendered by each section 272 affiliate to each Verizon BOC/ILECs during the Test Period.

a. Randomly select three individual non-consecutive months during the Test Period. For each month selected, obtain the billing records for all services that were billed by each section 272 affiliate to the Verizon BOC/ILECs. Billing records should be for all BOC/ILECs, all states, and reflect billing from all section 272 affiliates. Determine the number of services that make up 80% of total billing dollars. From the three months of billing records, randomly select 50 bills from the section 272 affiliates to the BOCs/ILECs; if the bill selected is not billing to a BOC/ILEC, continue replacement sampling until 50 bills to BOC/ILECs are selected. From the 50 bills, select two billing transactions with different rates for a total of 100 billing transactions to be tested; if a bill does not have two billing transactions select a transaction on another bill with more than two transactions to ensure a total of 100 billing transactions. (The same service may have different rates due to state differences, interLATA usage, intraLATA usage, etc.) After selection of the 100 billing transactions to the BOC/ILECs, determine if the same services are represented in the sample as the services that made up 80% of total billing dollars; consult the JOT for approval of the sample.

b. From each transaction selected in step 7a above, determine whether the amounts recorded for the purchase of the services in the books of the BOC/ILEC are in accordance with the affiliate transactions rules of the Commission (section 32.27). Compare unit charges to Fully Distributed Cost (FDC), Fair Market Value (FMV), or prevailing market price (PMP) as appropriate. Also check any "chain" transactions. Chaining may occur *when a section 272 affiliate provides an asset or service to a BOC/ILEC that was* originally obtained from another nonregulated affiliate, including if the section 272 affiliate obtained a product or service that was used to create the asset or service being provided to the BOC/ILEC. In such chain transactions, the section 272 affiliate must charge the lower of FDC or FMV of the original nonregulated affiliate unless there is a prevailing market price.[17] The costs recorded by the BOC/ILEC must reflect the actual costs the originating affiliate incurred in creating the asset or providing the service unless the originating affiliate had established a prevailing market price. When differences exist, note in the report the number of instances and the amount by which each item is different from the amount required by the rules. Inquire, obtain from management, and document in the report the reasons for these occurrences. Also disclose in the report the differences between the amount the BOC/ILEC has recorded for the transaction in its books of account, and the amount the BOC/ILEC has paid for the transaction to the section 272 affiliate.

c. For the sample of billing transactions selected in step 7a above, test that the transaction was properly recorded by the section 272 affiliate, and that the billed amount was paid by the BOC. This can be accomplished, for example, by inspecting the Accounts Receivable record of the section 272 affiliate (may be a computer screen) that identifies the method of payment such as check number(s), wire transfer(s), or any inter-company automatic settlement payment and/or treasury payment process, and, if needed, summaries of invoiced amounts corresponding to the amount paid. Obtain copies of all relevant documents and records, e.g., screens, summaries, etc., for the work papers. Disclose in the report each instance where a discrepancy is found in the billing or recording of the billing of the service by the section 272 affiliate, and each instance where the payment of the bill was not properly recorded, or not recorded.

8. Using the balance sheet and detailed listing information obtained in Procedure 4 under Objective I, for items added since January 3, 2005, perform the following steps:

a. For those items purchased or transferred from any Verizon BOC/ILEC, obtain net book cost and fair market value. Inquire, obtain from management, and document in the report how the fair market value was determined. Inspect these transactions to determine whether they were recorded in the books of the Verizon BOC/ILEC at the higher of FMV or net book cost, as required by the Commission's rules in section 32.27 and disclose in

[17] *See* In the Matter of NYNEX Telephone Companies' Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, AAD 7-1678, *Memorandum Opinion and Order*, Released October 11, 1988, paragraphs 23-25; *see also* In the Matter of Implementation of the Telecommunications Act of 1996; CC Docket No. 96-150, Accounting Safeguards Under the Telecommunications Act of 1996, *Report and Order*, Released December 24, 1996, footnote 376.

the report.

b. For those items purchased or transferred from another affiliate, identify and document in the report whether they were originally transferred from any Verizon BOC/ILEC to other affiliates.

c. For those items purchased or transferred from any Verizon BOC/ILEC, either directly or through another affiliate, since January 3, 2005, also inquire and obtain from management a narrative which details how the Verizon BOC/ILEC made an equal opportunity available to unaffiliated entities to obtain ownership of the facilities and disclose in the report. Describe and disclose in the report, based on inquiry and management's narrative provided, how and upon what basis the Verizon BOC/ILEC decided to transfer/sell the facilities to a section 272 affiliate instead of an unaffiliated entity.

9. Obtain as of the end of the Test Period a detailed listing of all fixed assets which were purchased or transferred from each section 272 affiliate to any Verizon BOC/ILEC since January 3, 2005. This detailed listing should include a full description of each item, location, date of purchase, price paid and recorded, and from whom purchased or transferred. For those items purchased or transferred from a section 272 affiliate, obtain net book cost and fair market value. Also determine if these items were originally transferred to the section 272 affiliate from some other affiliate (BOC or other), or purchased originally by the section 272 affiliate. Inspect these transactions to determine whether they were recorded in the books of the Verizon BOC/ILEC at the lower of FMV or net book cost, as required by the Commission's rules in section 32.27. Disclose results of this inspection in the report.

10. Where assets and/or services are priced pursuant to section 252(e) (i.e., as approved by the regulatory commissions) or statements of generally available terms pursuant to section 252(f), for a statistically valid sample of assets and/or services, compare the price each Verizon BOC/ILEC charges each section 272 affiliate to the stated price in the publicly-filed agreements or statements and document any differences in the report.

11. Inquire and obtain from management details as to whether any part of any Verizon BOC/ILEC's Official Services network was transferred or sold to a section 272 affiliate since January 3, 2005. In addition to the requirements for Procedure 8 above, for any transfer or sale of Official Services network assets on or after January 3, 2005, inquire and obtain from management a narrative which details how the Verizon BOC/ILEC made an equal opportunity available to unaffiliated entities to obtain ownership of the facilities. Through inquiry and from management's narrative, describe how and upon what basis the Verizon BOC/ILEC decided to transfer/sell the facilities to a section 272 affiliate instead of an unaffiliated entity. Disclose all of the above facts in the report.

OBJECTIVE VII. Determine whether or not the Bell operating company has discriminated between the separate affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or the establishment of standards.

STANDARDS

The FCC in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, establishes some non-discriminatory rules and regulations. These rules and regulations do not permit a Bell operating company (BOC) to discriminate in the following manner:

- by giving preference to a section 272 affiliate's equipment in the procurement process. (See First Report and Order, para. 16)

- in awarding contracts for telecommunications equipment directly to their affiliate in a manner that violates section 273(e)(1) or 273(e)(2). (See First Report and Order, para. 234)

- by failing to provide advance information about network changes to its competitors. (See First Report and Order, para. 16)

- by not offering third parties the same goods, services, facilities and information (excludes customer proprietary network information (CPNI) and joint marketing) that it provides to its section 272 affiliate at the same rates, terms, and conditions. (See First Report and Order, para. 202 and 218)

NOTES:

(i) BOCs are not required under the nondiscrimination rules and regulations to provide to third parties Customer Proprietary Network Information (CPNI) that is shared with affiliates (see *Second Report and Order*, CC Docket No. 96-115, Released February 26, 1998, para. 169). The provision of "information" referenced in the nondiscriminatory rules and regulations excludes CPNI. CPNI is defined in section 222(f)(1) of the Act and includes information that is personal to customers as well as commercially valuable to carriers, such as to whom, where and when a customer places a call, as well as the types of service offerings to which the customer subscribes and the extent the service is used.

(ii) BOCs are allowed to jointly market and sell affiliate-provided interLATA services without offering comparable joint marketing opportunities to other providers of interLATA services (see section 272(g)(2) of the Act, and CC Docket No. 96-149, First Report and Order, Paragraphs 291-292). However, if BOCs market or sell their telephone exchange services through joint marketing conducted by the section 272 affiliate, then the BOCs must also permit third parties to market and sell its telephone exchange services (see section 272(g)(1) of the Act).

- in establishing or adopting any standards that favor its section 272 affiliate(s) over third parties. (See First Report and Order, para. 208 and 229)

- in developing new services solely for its section 272 affiliate(s). (See First Report and Order, para. 210)

- in purposely delaying the implementation of an innovative new service by denying a competitor's reasonable request for interstate exchange access until its section 272 affiliate was ready to provide competing service. (See First Report and Order, para. 211)

- in marketing its affiliate's interLATA services to inbound callers without informing them of their right to select the interLATA carrier of their choice. (See First Report and Order, para. 292)

NOTE:

A BOC's obligation to inform callers of their long distance choices is limited to customers who order *new* local exchange *service*. A caller orders "new service" when the customer either receives service from the BOC for the first time, or moves to another location within the BOC's in-region territory. (*See In the Matter of AT&T Corp., Complainant, v. New York Telephone Company, d/b/a Bell Atlantic – New York, Defendant*, Memorandum Opinion and Order, File No. EB-00-MD-011; FCC 00-362; at ¶¶ 13-15.)

In addition, a section 272 affiliate may not market or sell information services and BOC telephone exchange services together, unless the BOC permits other information service providers to market and sell telephone exchange services. (See First Report and Order, para. 287)

PROCEDURES

1. Obtain the Verizon BOC/ILECs' written procurement procedures, practices, and policies.

Inspect these policies for any stated purchasing preferences, and disclose in the report. Also disclose in the report the bidding and selection processes of the Verizon BOC/ILECs, and how the Verizon BOC/ILECs disseminate requests for proposals (RFPs) to affiliates and third parties.

2. Obtain and inspect the Verizon BOCs' procurement awards to each section 272 affiliate during the Test Period and inspect bids submitted by each section 272 affiliate and third party, note terms, and discuss with Verizon BOC representatives how the selection was made and disclose in the report. Compare this practice with the Verizon BOC/ILEC written procurement procedures and note any differences. Disclose in the report all instances of procurement awards given to the section 272 affiliates. For these awards, disclose in the report the general differences between the terms submitted by the section 272 affiliates and other bidders.

3. Obtain a list of all goods (including software), services, facilities, and customer network services information, excluding CPNI as defined in section 222(f)(1) of the Act, and exchange access services and facilities inspected in Objective IX, made available to each section 272 affiliate by the Verizon BOC/ILECs. For a statistically valid sample of items from this list, inquire and obtain copies of the media used by the Verizon BOC/ILECs to inform unaffiliated entities of the availability of the same goods, services, facilities, and information at the same price, and on the same terms and conditions. Disclose in the report the results of this procedure.

4. a. Obtain a list of all goods (including software), services, facilities, and customer network proprietary information (excludes CPNI) that were purchased during the Test Period from the BOC(s) by both an unaffiliated entity and any section 272 affiliate in any state. (NOTE: This list should **exclude** exchange access services, local exchange services, and interLATA services that are the subject of other procedures.) If any, describe in the report what goods, services, facilities, and customer network services information were purchased and the amount of purchases made. From the list obtained above, determine the 9 goods/services billed to unaffiliated third parties with the highest billing volume in dollars (determination should be made based on accumulated billing to all unaffiliated entities). In addition, randomly select one service from among the remaining services for a total of 10 services to be tested. For each service selected, determine the billing system(s) used by each BOC to bill the service, and disclose in the report whether the same system(s) is used for the billing of both the section 272 affiliates and unaffiliated third parties.

(1) Inquire, obtain from management, and document in the report a narrative of the BOC procedures for ensuring that the applicable tariff or agreement rate is billed to both the section 272 affiliates and nonaffiliates (e.g., the same rate table is used for all carriers). For each service selected, obtain the billing system rate

tables. Randomly select three rates per service including any applicable *discounts, surcharges, late fees, etc., used to bill the selected service to the section* 272 affiliates. Determine if the rate tables in place reflect the current tariff or agreement rates, and disclose in the report. For the services selected, determine whether the applicable rates used to bill the section 272 affiliates are equal to or greater than those billed to nonaffiliates. Inquire, obtain from management, and document in the report a narrative of the BOCs' procedures for updating the rate tables for the Test Period.

(2) For each billing system identified that is used to bill section 272 affiliates, document in the work papers the practices and processes the Verizon BOCs have in place to ensure the billing system bills the section 272 affiliates and nonaffiliates at the same rates and under the same terms and conditions. Document the BOC internal controls and procedures designed to ensure non-discriminatory billing. Include in the description of internal controls a summary of controls in place for overseeing the system, e.g., who has access to the systems to examine bills for accuracy, who authorizes changes if there is an error, and who has control and access over changing the rate tables (or the equivalent mechanized/system controls). Inquire, obtain from management and include in the report a summary of what each billing system is, what services are billed under that system, what controls are present for each system, and whether the controls apply equally to both the section 272 affiliates and nonaffiliates. Also inquire, obtain from management and include a summary of the controls that the BOC(s) has in place for recording billed amounts as revenue, and the controls in place for recognizing and recording when the billed amount is actually paid. For each control identified, inquire of management and document in the report how these controls exist and apply equally to both the section 272 affiliates and nonaffiliates.

b. Randomly select three individual non-consecutive months during the Test Period. For each month selected, obtain the billing records/invoices for the services to be tested that were identified in step a. above that were billed to section 272 affiliates. Billing records should be for all BOCs, all states. From the three months of billing records/invoices, randomly select 10 invoices. On each of the 10 selected invoices, select ten line items/services to ensure that there are at least 10 different items/services selected in the overall sample. For each line item selected, test each transaction for the proper application of the billing rate table tariff or agreement rate in effect at the time of the transaction. Determine if the amount billed was calculated using the appropriate rate in the rate table. If historic rate tables are not available and the number of line items/rates for which rate tables are not available is 10 or less, note in the report that the rates were not available and that the test could not be performed for those items. Note how many items were not able to be tested. If more than 10 historic line item rates are not available, perform the test by obtaining the most recent month of billing records available for the service shown on the line items. Test that the current rate tables obtained in step a. above, including all applicable discounts, surcharges, late fees, etc., are being applied to the applicable line item service. Note that this alternate procedure was performed, and the results, in the report.

c. For each billing system that is used by the BOC(s) to bill unaffiliated entities that is different than a billing system used to bill the same service to a section 272 affiliate, perform the procedures listed in steps a(1) and a(2) above. For each service to be tested identified in step a, compare the rates (including all terms and conditions, discounts, surcharges, late fees, etc.) charged for the service (in this system to bill unaffiliated entities) to the comparable rate charged in the system used to bill the service to a section 272 affiliate. Disclose in the report any differences. Disclose the results of all the billing system testing, outlined above, in the report.

d. Using the same randomly selected three individual non-consecutive months identified in step b above, obtain the billing records/invoices from each billing system tested in step c above (each system used to bill nonaffiliated entities that is different than the system used to bill the same service to section 272 affiliates), for the services to be tested identified in step a above that were billed to unaffiliated entities. Billing records should be for all BOCs, all states. Randomly select 10 invoices, and for each invoice judgmentally select ten line items. Ensure that the judgmental sample includes a representation of the same services tested in step b above. If the judgmental sample is not representative of the same services tested in step b above, repeat selection of the judgmental sample. For each line item selected, test each transaction for the proper application of the billing rate table tariff or agreement rate in effect at the time of the transaction. If historic rate tables are not available, perform the test with the current rate tables obtained in step c. above, including all applicable discounts, surcharges, late fees, etc. Determine if the amount calculated to be billed was calculated using the appropriate rate in the rate table. Also, for each line item test that the transaction, including the subsequent receipt of payment or the equivalent, was properly recorded by the BOC, and that the billed amount was paid. This can be accomplished, for example, by inspecting the Accounts Receivable record of the BOC (may be a computer screen) that identifies the method of payment such as check number(s), wire transfer(s), and, if needed, summaries of invoiced amounts corresponding to the amount paid. Obtain copies of relevant documents and records, e.g., screens, summaries, etc., for the work papers. Disclose in the report each instance where a discrepancy is found in the billing or recording by the BOC of the billing of the service to the nonaffiliate, and each instance where the payment of the bill was not properly recorded, or not recorded.

e. For local exchange services purchased from the BOCs by both an unaffiliated entity and any section 272 affiliate, obtain for one month, randomly selected, detailed billing data reports for the three states that provide the majority of local exchange services to the former Verizon section 272 affiliates in 2005. Obtain detailed billing data reports for unaffiliated customers with the same class of service in these same three states for the same month. For each state selected, identify the 9 USOCs billed to the section 272 affiliate(s) with the highest dollar volumes, plus one additional USOC selected at random. Document in the audit report which system(s) is used to bill local exchange services. Also inquire and document how the BOCs update the rate tables in the billing system(s) used for local exchange services. For each of the thirty (30) section 272 affiliate USOCs as selected above, select 3 nonaffiliated transactions with the same USOC and compare the USOC rates charged to the section 272 affiliate(s) to the rates charged to unaffiliated customers. Disclose in the report any differences and explanations from management for such differences. Also test the billing to the section 272 affiliate(s) by randomly selecting 25 invoices for the month selected and determine if the invoice was properly recorded by the BOCs, and that the billed amount was paid. Disclose in the report each instance where a discrepancy is found in the recording of the bill by the BOC, or in the payment of the bill by any section 272 affiliate.

5. Obtain from management, document and disclose in the report how the Verizon BOCs disseminate information about network changes, the establishment or adoption of new network standards, and the availability of new network services to each section 272 affiliate and to unaffiliated entities. Note any differences of how information is disseminated to section 272 affiliates and unaffiliated entities in the report.

6. At the service call centers observed in Procedure 7 below, obtain and inspect scripts that the Verizon BOCs' customer service representatives recite to new customers calling, or visiting customer service centers, to establish new local telephone service or to move an existing local telephone service to another location within the BOC in-region territory. In addition, obtain the script that is used in Verizon's Consumer Call Centers' Voice Response Unit (VRU). If these scripts contain language to attempt to sell interLATA services, note and disclose in the report whether these scripts inform the consumers that there are other providers of interLATA services and that these providers, along with the interLATA service affiliates, are identified to the consumers. In addition, obtain and inspect the written content of the Verizon BOC website for on-line ordering of new service or to move an existing local telephone service; note and disclose in the report whether the consumers are informed that there are other providers of interLATA services and that these providers, along with the interLATA service affiliate, are identified to the consumers.

7. Obtain a complete listing, as of the end of the Test Period, of all Verizon BOC sales and support customer service call centers.

    a. From the listing, compile a list of Verizon BOC call centers responding to inbound callers requesting to establish new local telephone service or to move an existing local telephone service to another location within the BOC in-region territory. From this listing, identify and group each call center by type of customers, viz., "Consumer" or "Business." Using a random number generator, select six Consumer call centers and four Business call centers. Listen in to a statistically valid number of calls (100 in total, or 10 per call center) in which the customer service representatives attempt to market the section 272 affiliate's interLATA service to callers requesting to establish new local telephone service or to move an existing local telephone service. Labor union concurrence may be needed for this procedure. Note the equal access messages conveyed while listening in, including clarity of the equal access message delivered. Note and disclose in the report any instances where the customer service representative attempted to influence the caller to obtain the interLATA services of the section 272 affiliate prior to providing the equal access message, did not inform the caller of other providers of interLATA services, or did not inform the caller of his right to select the interLATA services provider.

b. From the listing, compile a list of call centers that might incidentally respond to inbound callers requesting to establish new local telephone service or to move an existing local telephone service to another location within the BOC in-region territory (such as sales and service centers that usually receive customer inquiries from existing customers). Using a random number generator, select three such Consumer call centers and two Business call centers, and listen in to 20 calls per center. Labor union concurrence may be needed for this procedure. If any customer requests to establish new local telephone service or to move an existing local telephone service, the practitioner should report the results of the 100 total calls to the Oversight Team for further instructions. The Oversight Team will inform Verizon of the instructions provided to the practitioner.

c. Make a statistically valid number of test calls into Verizon's Consumer Call Centers' Voice Response Unit to listen for the equal access scripting message that is heard by customers prior to reaching a Consumer service representative. Note and disclose in the report any instances where the equal access scripting message was not heard.

8. Obtain a listing of all call centers managed by third parties in which representatives of third-party contractors of the Verizon BOC respond or might incidentally respond to customers requesting to establish new local telephone service or to move existing local telephone service to another location within the BOC in-region territory. Using a random number generator, select three Consumer call centers and one Business call center. Listen in to 25 calls per call center. If any customer requests to establish new local telephone service or to move an existing local telephone service, the practitioner should report the results of the 100 total calls to the Oversight Team for further instructions. The Oversight Team will inform Verizon of the instructions provided to the practitioner.

9. Obtain from management and disclose in the report the controls utilized by Verizon BOCs and the third party contractors hired for inbound telemarketing to assure compliance by Verizon BOCs with section 272. Compare Verizon BOC controls with third party contractor controls and document differences in the report. Describe all controls in the report.

10. Obtain and inspect each of the contracts between Verizon BOCs and third party contractors that provide telemarketing of the section 272 affiliate's interLATA services. Document in the audit report all controls contained in the contracts relating to section 272.

OBJECTIVE VIII. **Determine whether or not the Bell operating company and an affiliate subject to section 251(c) of the Act have fulfilled requests from unaffiliated entities for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or its affiliates.**

STANDARDS

Although the FCC in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, reached various conclusions, further proceedings regarding performance measurements (currently underway) will provide the implementing rules and regulations. We will revise these procedures to conform to the new rules and regulations when adopted by the FCC and to the extent in effect during the engagement period. In the Order approving the application of Verizon to merge with MCI (FCC 05-184, APPENDIX G, Attachment A), the FCC mandated performance reporting for interstate access services. (See footnote 16)

The conclusions reached by the Commission provide that,

- for equivalent requests the response time a BOC provides to unaffiliated entities should be no greater than the response time it provides to itself or its affiliate. (See First Report and Order, para 240)

- a BOC must make available to unaffiliated entities information regarding the service intervals in which the BOC provides service to itself or its affiliates. (See First Report and Order, para. 242)

- a BOC must not provide a lower quality service to competing interLATA service providers than the service it provides to its section 272 affiliate at a given price. (See First Report and Order, para. 16)

In its section 271 applications, Verizon made commitments regarding compliance with section 272(e)(1) of the Act. This included the commitment to provide the performance monitoring that will assist in confirmation of nondiscriminatory performance in Verizon's dealings with its section 272 affiliates. If the Commission adopts reporting requirements, Verizon BOC/ILEC will fully comply.

PROCEDURES

1. Document in the working papers the practices and processes each Verizon BOC/ILEC has in place to fulfill requests for exchange access service for the section 272 affiliates, BOC